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Supreme Court of the United States

OCTOBER TERM, 1947

No. 449

JOHN A. LAIRD, *Petitioner*,

v.

UNITED SHIPYARDS, INC., JOSEPH W. POWELL, HUBERT E. ROGERS, and THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF INDIVIDUAL RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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THE COURT PRESS, N. Y. C.

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Opinions Below.

The Opinion of the District Court (R. 1230-1250) is unreported. The Opinion of the Circuit Court of Appeals is reported at 163 F. (2d) 12.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered August 13, 1947 (R. 1280). The petition for a writ of certiorari was filed November 13, 1947 and served November 14, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Preliminary Statement.

This is a derivative suit on behalf of United Shipyards, Inc., begun on September 18, 1940, more than 10 years after the acts complained of, which occurred in February, 1929.

After trial, the District Court found no fraud, breach of fiduciary obligation, or overreaching by any defendant, no damage to the corporation, and further that the alleged cause of action accrued more than 10 years before suit (fols. 3775, 3776, 3797, 3799, 3800).

The Circuit Court of Appeals affirmed all the facts found below.

The only question of law which the Circuit Court of Appeals deemed necessary to mention was that under *Guaranty Trust Co.* v. *York,* 326 U. S. 99, the cause of action was barred under controlling New York law.

Petition Misstates Questions Involved.

The only question presented by this writ is whether the Circuit Court of Appeals misconstrued the controlling New York decisions interpreting its Statute of Limitations, but—

Petitioner cites no case to support any contention that the Court below "decided an important question of local law in a way probably in conflict with applicable local decisions" (Rule XXXVIII, subd. 5 [b]).

The only question of law decided by the Circuit Court of Appeals was that under the controlling New York State law the suit was barred by the 10-Year

New York Statute of Limitations (N. Y. Civ. Prac. Act, Sec. 53), and that accrual was not postponed until discovery by Section 48(5) of the New York Civil Practice Act. The District Court had decided the case on the facts in favor of defendants under the controlling state law, and had also decided that under state law the cause of action had in fact accrued more than ten years before suit (fol. 3775), but did not pass on the applicable statute of limitations because the appeal in *Guaranty Trust Co.* v. *York,* 326 U. S. 99 was then pending undecided.

The petition misstates the holdings below when it asserts that the lower courts held anything "under the 'federal' rule" (p. 1).

No question is presented as to whether "a federal court may in a diversity suit ignore state law" (p. 2).

Decision Below Correct.

The decision below that the New York statute was a bar was correct.

The affirmance could have been justified solely on the findings of fact of the District Court, many of which are recited in the opinion of affirmance. No questions of law such as are tendered by petitioner survived these findings of fact.

In any event, the questions of law mentioned in the opinion of the District Court were correctly resolved under the controlling New York law, even though unnecessary to the decision after *Guaranty Trust Co.* v. *York,* 326 U. S. 99, as the Circuit Court of Appeals concluded.

Affirmance Solely on Ground That the Controlling New York Statutes of Limitation Were a Bar.

As appears from the opinion of the Circuit Court of Appeals, its affirmance was predicated solely on its construction of the New York Statute of Limitations (p. 1279):

> "We find it unnecessary to set forth in greater detail either the facts found or the claims made by the respective parties for in our opinion the New York statute of limitations is a bar to the suit.
>
> * * * *
>
> It may be that the trial judge did not base his decision upon this ground because *Guaranty Trust Co.* v. *York,* 326 U. S. 99 had not then been decided. That case now shows conclusively that the New York statute of limitations does apply. That statute, as construed by the New York courts, had run before this suit was brought."

The only question, therefore, which petitioner may raise as a ground for certiorari is whether the Court of Appeals erred in its holding that the New York statute "as construed by the New York Courts, had run before this suit was brought."

Nowhere does petitioner cite a New York case which holds (or even suggests by dictum) that the New York statute does not bar any corporate claim on the facts here involved.*

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* Curiously enough, petitioner's only reference to New York cases construing the New York Statute of Limitations is found in a footnote (9) on page 15 and in the one page Appendix III on page 23.

New York Cases Construing New York Statutes Correctly Interpreted.

The *ratio decidendi* below was:

> "There was no allegation or proof of fraud—of the kind which is found in *Reno* v. *Bull,* 226 N. Y. 546, 550. Such fraud must necessarily be pleaded and proved to establish a cause of action on which, by virtue of Sec. 48 (5) of the Civil Practice Act, the statute does not begin to run until discovery. *Hastings* v. *Byllesby & Co.,* 293 N. Y. 404."

That such fraud must necessarily be pleaded and proved to delay accrual until discovery has recently been restated in *American Cities Power & Light Corp.* v. *Williams,* 69 N. Y. S. 2d 197, 202:

> "In order to bring the case within Section 48 (5) of the Civil Practice Act the allegations must be sufficient to charge fraud and deceit with all the elements present, as outlined in the leading case of *Reno* v. *Bull* (226 N. Y. 546)."

Reno v. *Bull,* 226 N. Y. 546, required that the person asserting the cause of action—here the corporation—had relied on a false representation and that such person—here the corporation—had relied thereon to its injury.

Here, admittedly, any representation claimed to have been false was made by the corporation itself to prospective purchasers of its stock thereafter to be marketed, and hence could not have been relied on by the corporation to its injury upon its organization.

We annex as an Appendix our argument below on the Statute of Limitations (p. 11, *infra*).

There Were No Facts Such as Are Necessary to Postpone Accrual Under New York Law and the Findings Negative Any Such Facts.

There was, however, no false representation. The only representation claimed (Petition, p. 3) is that the prospectus "made it appear that options on the six properties were held by United and that the aggregate price of $20,090,000 in cash and securities was to go to the named vendors."

Neither Court below found any representation to have been false.

The District Court found (II, pp. 1266-1267) that "None of the defendants * * * conspired to defraud or injure United or any of its stockholders, present or prospective" and that "The transactions complained of were openly and fairly made for the benefit of its stockholders. There was no fraud or concealment."

These findings were not reversed by the Circuit Court of Appeals.

The only alleged misrepresentation in the prospectus was the statement that "options or agreements to purchase these properties have been secured for" certain stated cash, mortgages and securities which included the 4,400 shares of preferred, concerning which petitioner complained. The options had in fact been secured for United, recited that they had been secured for a corporation to be formed (fols. 1954, 1853, 1910, 1928, 1940), were alleged in the amended complaint to have belonged to United (I, pp. 46.20) and were admittedly exercised by United.

There was therefore no misrepresentation.

Nor could the corporation have relied on any prospectus misrepresentation, had any been made, since the corporation drew up and issued the prospectus, and did not rely on it in issuing the 4,400 shares of preferred. They were issued in order to acquire shipyard properties which the corporation could not otherwise have acquired, as we next show.

On the Merits, the District Court's Unreversed Findings of Fact Are That There Was No Profit to Defendants or Injury to the Corporation.

There was not even a profit, much less any secret profit.

The District Court found that the 4,400 shares of preferred "were issued in good faith and for a good, valid and valuable consideration" (II, p. 1258). Powell and Rogers acquired these shares in return for purchasing for $1,700,000 cash, purchase money mortgages which the corporation had given in order to acquire the Shewan and Crane shipyard properties. When the Shewan and Crane interests refused to accept mortgages instead of cash and the corporation had insufficient funds to pay cash, Powell and Rogers advanced $1,700,000 for these mortgages and the 4,400 shares of preferred, both of which they intended to resell in a package for $1,700,000 (fols. 287, 226, 228). Their hopes were foiled by subsequent events and they unwillingly found themselves holding the bag for almost ten years.

The District Court found (II, p. 1258):

"36. At the time of acquisition of the Shewan mortgage and the interest in the Crane mortgage

> by defendants, Rogers and Powell, there was no profit to said purchasers at the expense of United or at the expense of anyone then interested or about to become interested in United. * * *
>
> "38. Defendants, Powell and Rogers, realized no secret profit as a result of the Shewan and Crane transactions, and the acts of Rogers and Powell in connection with the Crane and Shewan transactions were carried on in good faith."

In affirming, Chase, *Ct. J.*, quoted these findings (p. 1278) after observing that:

> "These purchases were made, after fruitless attempts to find other purchasers, to enable United to take up the options."

Questions Considered by the District Court, but Not Decided by Circuit Court of Appeals.

(a) Whether under the facts found New York law gave the corporation any cause of action.

The District Court found as a matter of fact that "None of the defendants cheated or defrauded United", that none of them "conspired to defraud or injure United" (II, p. 1266). "The transactions complained of were openly and fairly made for the benefit of its stockholders. There was no fraud or concealment" (II, p. 1267), that defendants "realized no secret profit as a result of the Shewan and Crane transactions" (II, p. 1259) and that "At the time * * * there was no profit to said" defendants "at the expense of United or at the expense of anyone interested or about to become interested in United" (II, p. 1258).

In its opinion, the District Court considered whether, under these facts, including the charter provision which permitted defendants to deal with the company in the absence of fraud (Ex. 9, p. 630), the corporation could have any cause of action under New York law.

It concluded that under the circumstances the assent of all the then shareholders barred the corporation under the controlling New York law, citing *Blum* v. *Whitney,* 185 N. Y. 232 (II, p. 1239), especially since in the absence of fraud its promoters were authorized by its charter to deal with the corporation, citing *Everett* v. *Phillips,* 288 N. Y. 227 (II, p. 1243).

We urged on appeal that there was no recoverable damage or profit under the controlling New York law; or for that matter under any law where as here there was no factual proof of fraud, and charter authorization to deal with the corporation.

The Circuit Court of Appeals elaborately stated the facts and pertinent findings below, but found it unnecessary to pass on these questions of law argued.

(b) Whether the final order in the 77-B proceeding prevented the corporation from asserting a claim arising out of the Crane and Shewan transaction.

The 4,400 shares of preferred in question were exchanged as part of an elaborate compromise effected in 77-B many years later, for shares in the reorganized company. The District Court held as a matter of federal law that this was a valid defense.

On appeal, we urged the correctness of this holding, (1) as a *res adjudicata* and estoppel by judgment, (2) because thereafter any alleged profit was the result of ownership under court order, not of breach of fiduciary duty, and (3) because the corporation was estopped by that compromise to assert alleged rights then already almost ten years old.

The Circuit Court of Appeals did not pass upon this defense, merely mentioning in passing that the shares had been exchanged in a 77-B proceeding and that "After the reorganization and the outbreak of World War II a good sale of all the properties of the reorganized corporation was made and the amount thus realized doubtless became the financial incentive for bringing this suit."

Since the Circuit Court of Appeals never passed on this defense, there is no point in making the argument here.

CONCLUSION.

The petition for certiorari should be denied.

Dated, December 2, 1947.

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Appendix.

"POINT IV.

The cause of action is barred by the Statutes of Limitation.

A.

The New York Statutes of Limitation govern both the time of accrual and time within which suit at law or in equity must be brought.

Guaranty Trust Co. v. *York* (1945), 326 U. S. 99;
West v. *A. T. & T. Co.* (1940), 311 U. S. 223, 236;
Fidelity Trust Co. v. *Field* (1940), 311 U. S. 169, 178;
Stoner v. *N. Y. Life Ins. Co.* (1940), 311 U. S. 464, 467.

B.

Under New York law, any cause of action accrued at the time of such transactions.

Whatever may be the rule in some other jurisdictions, the courts of New York have steadfastly refused for over a century to permit the judiciary to graft additional exceptions on the controlling statutory periods of limitations. The remark of Spencer, *Ch. J.*, in 1822 in *Troup* v. *Smith's Ex'rs*, 20 Johns. 33, 47, is equally true today:

> '* * * I know of no dispensing power which courts of law possess, arising from any cause whatever * * *.'

Many of the subsequent cases reiterating this principle and applying it to a wide variety of situations are collected in *Turner* v. *American Metal Co.*, 36 N. Y. S. (2d) at 379.

Control of the corporation by the alleged wrongdoers does not toll the applicable statute.

Zwerdling v. *Bent* (1943), 291 N. Y. 654;
Lever v. *Guaranty Trust Co.* (1942), 289 N. Y. 615;
Pollack v. *Warner Bros. Pictures Inc.* (1943), 266 App. Div. 118, 120.

In the *Zwerdling* case, 'The appellant [unsuccessfully] urged in the Court of Appeals, among other things, that * * * the action was not barred until relinquishment of control by the directors alleged to be delinquent and to constitute a majority of the board' (291 N. Y. at 655). In the *Lever* case, the same claim was advanced again unsuccessfully against a motion directed to the complaint which alleged that defendants 'possessed and exercised, during such entire ten-year period, substantially complete control and domination of the board of directors' (289 N. Y. at 617). In the *Pollack* case, the Court said the statute ran 'regardless * * * of the continuance in control by appellants' (266 App. Div. at 120).*

(1) *Accrual was not postponed until discovery.*

A cause of action in a derivative suit to recover from a director profits improperly made at the expense of his corporation on the sale to it of property (*Hastings* v. *Byllesby & Co.* [Haystone] (1944), 293 N. Y. 404; *Teich* v. *Lawrence* (1943), 291 N. Y. 245; *Lever* v. *Guaranty Trust Co.* (1942), 289 N. Y. 615; *Gobel, Inc.* v. *Hammerslough* (1941), 288 N. Y. 653) accrues at the time of the sale and not at the time of 'discovery'.

In *Teich* v. *Lawrence* (1943), 291 N. Y. 245, the Appellate Division did not dismiss the first cause of action as barred by the statute because 'The action is for actual fraud, in that respondents participated in a scheme

* Others *ad infinitum* could be mentioned by reference to the cases on appeal. The proposition is so obvious to the New York minority stockholders' bar that it is usually not urged and the New York courts do not bother to discuss it. Indeed, an overwhelming majority of such suits allege, as an excuse for failure to demand that the corporation bring suit, domination and control by the wrongdoers.

wherein certain stock was sold to [the nominal defendant] the Equity Corporation's subsidiary for a grossly inflated price, the proceeds of which sale were paid through respondents' corporations to the majority stockholder of the Equity Corporation, and in return for all of which respondents obtained the stock which gave them control of the Equity Corporation. * * * the transaction was an actual fraud and nothing else, and the time for bringing an action thereon began to run from the date of the discovery of the fraud * * *' (265 App. Div. 974, 975). The Court of Appeals reversed and dismissed this cause of action as barred, saying *per curiam* (p. 249):

> 'This was error. A stockholders' derivative action belongs to the corporation that has been wronged. The present complaint alleged no fraud upon the defendant corporation in whose behalf the plaintiffs sue. (See *Lever* v. *Guaranty Trust Co.*, 289 N. Y. 615.)'

In *Hastings* v. *Byllesby & Co.* [Haystone] (1944), 293 N. Y. 404, the 16th cause of action alleged a 'corrupt and fraudulent conspiracy * * * to obtain large profits and substantial personal benefits at the expense of the debtor corporation' which was consummated by the conspirators receiving from the corporation 'valuable stock in subsidiary corporations and large sums of money in exchange for stock which had cost' the conspirators 'much less', one of the conspirators selling 'some of the stock thus received for $25,000,000' (p. 408). In affirming the dismissal as barred by the Statute, Lehman, *Ch. J.*, wrote (p. 411):

> 'The allegations of the complaint that the defendants conspired to secure "fraudulent" profits and acted in "fraud" of the corporation * * *even if accepted as allegations of fact * * * are only incidental to the cause of action brought against the defendants on the ground that they have disregarded their duty to the corporation. Such allegations do

not constitute a cause of action "to procure a judgment on the ground of fraud" which, under the provisions of section 48, subdivision 5, of the Civil Practice Act, "is not deemed to have accrued until the discovery * * * of the facts constituting the fraud". *Gobel, Inc.* v. *Hammerslough*, 263 App. Div. 1, affd. 288 N. Y. 653; *Dunlop's Sons, Inc.* v. *Spurr*, 285 N. Y. 333.)'

An example of when Section 48, subdivision 5, applies even though a fiduciary duty has also been violated is *Mannaberg* v. *Klausner* (1945), 294 N. Y. 859. There '"The complaint contains allegations sufficient to sustain a cause of action for fraud in that by *false representations* the plaintiff was *induced to consent to the sale of an asset of the partnership*. To such a cause of action the six-year Statute of Limitations would apply only from the date of discovery of the fraud (Civ. Prac. Act, Sec. 48, subd. 5) even when the fraud is practiced by a partner upon another member of the partnership"' (p. 860).

But to bring his corporate cause of action within the discovery section, plaintiff must prove as to the corporation all the elements of the classic fraud case of *Reno* v. *Bull* (1919), 226 N. Y. 546, 550. It is vital that the fraud relied on be the *inducement to the company's* act from which *the damage flowed*.

Here the corporation knew that Powell and Rogers were interested in the Crane and Shewan transactions and that without their aid it could not acquire said properties.

Moreover, the complaint here seeks solely the recovery of alleged profits (fols. 37, 38, 40, 137.27, 138.36, 137.40).

But in an action for fraud, 'All elements of profit are excluded' (*Reno* v. *Bull* [1919], 226 N. Y. 546, 553).

There is not even proof of overvaluation in the issuance of securities (pp. 14-17, *supra*) which if gross enough, is

sometimes loosely characterized as a fraud when the 'discovery' section of the Statute is not at issue.

In a very recent case, *American Cities Power & Light Corp.* v. *Williams*, not yet officially reported,* recovery was sought against the dominating director and a company of which he owned a majority of the stock for profits allegedly made by him and said company at the expense of plaintiff corporation. In dismissing causes of action as barred by the Statute, Mr. Justice Shientag reviewed at length the existing state of New York law with respect to so-called 'fraud' actions under Section 48 (5):

> 'Here, in essence, the wrong charged was breach of fiduciary duty in the waste of corporate funds. The charge that the breach was fraudulent does not operate to change the essential character of the wrong claimed.
>
> In order to bring the case within Section 48 (5) of the Civil Practice Act the allegations must be sufficient to charge fraud and deceit with all the elements present, as outlined in the leading case of *Reno* v. *Bull* (226 N. Y. 546).
>
> I can find no allegations of fraud other than the matters cited relating to failure to disclose to the corporation. It is conceded on the argument, however, that all of the directors of the corporation were quite aware at all times of the transactions which were taking place and there is no allegation that the directors were misinformed or ignorant of the facts when they acted. The corporation is therefore chargeable with notice and no cause of action for non-disclosure is pleaded unless we adopt plaintiffs' argument that there should have been a disclosure to the stockholders, members of the public who had no chance to discover the facts.
>
> * * * *
>
> Referring further to the contention of plaintiffs

* Now reported in 69 N. Y. S. (2d) 197, 202, 204

that the six causes of action are protected because of failure to disclose the facts to the stockholders and that, therefore, section 48 (5) of the Civil Practice Act applies, I am unable to find any decisions which hold to that effect. Once it is conceded that at the time the action was taken by Williams the other directors knew what was being done, it seems clear that the corporation is chargeable with such knowledge. In such a situation the only people from whom it may be said that there has been a concealment are the general class of innocent, uninformed stockholders. This does not give a cause of action under section 48 (5) many years later, when the innocent stockholders discover the facts. This was decided by the Court of Appeals in *Lever* v. *Guaranty Trust Co.* (289 N. Y. 615). There the court made an order dismissing the complaint, which alleged that the damaging facts had never been disclosed and were still unknown to the stockholders generally and that the plaintiff stockholder first discovered the existence of the facts during the year in which he brought suit. In *Teich* v. *Lawrence* (291 N. Y. 245), a similar claim of concealment from stockholders was made. The Court of Appeals cited the decision in the *Lever* case with approval, saying: "A stockholder's derivative action belongs to the corporation that has been wronged. The present complaint alleged no fraud upon the defendant corporation in whose behalf plaintiff sued."'

There is nothing here even remotely resembling 'an action to procure a judgment on the ground of fraud' within the meaning of Section 48 (5).

(2) *No new cause of action accrues if later the mala fide fiduciary reaps additional profit by selling the property or investing the funds which he had wrongfully acquired.*

Equity Corp. v. *Groves* (1945), 294 N. Y. 8;

Hastings v. *Byllesby & Co.* [Haystone] (1944), 293 N. Y. 404.

The Court below correctly found that any claim based on the Crane and Shewan transactions accrued on or prior to February 28, 1929 (Finding No. 83, fol. 3800).

It made no conclusion of law as to the statute presumably because it was either unnecessary or inadvisable since the *York* case had not then been decided by the Supreme Court.

C.

Under New York law the Shewan and Crane causes of action were barred because they accrued more than ten years before suit was begun.

The Shewan and Crane transactions occurred early in 1929 (Findings Nos. 34-37, fol. 3773). Suit was begun in September 1940 (Finding No. 82, fol. 3800), more than ten years after accrual of any cause of action (Finding No. 38, fol. 3775). Any claim based thereon is therefore in any event barred by the ten-year statute (N. Y. Civ. Prac. Act., Sec. 53).

D.

In any event, the claims are barred by 'discovery' within the meaning of Section 48 (5) more than six years before suit.

But even if Section 48 (5) applied, the claim would be barred since there was 'discovery' within the meaning of that subdivision more than six years before suit was begun. Suit was begun on September 18, 1940. Six years before that United was already in 77-B reorganization (Exs. J-I, 02, pp. 1011, 1025) where all claimants and security holders had access to its Minute books. The Minutes of January 18, 1929 set forth in full for all who chose to read the very same facts from which plaintiff seeks to infer a 'secret profit' (Ex. 13-C, pp. 769-776).

Under New York law, plaintiff must prove that United did not discover facts sufficient to put it upon inquiry* more than six years before the commencement of suit (*Mason* v. *Henry*, 152 N. Y. 529 at 539).

No such proof was adduced. The majority of the Board was independent from March 6, 1929 (p. 26, *supra*),—certainly from April 3, 1929 (p. 27, *supra*). Such evidence as there is indicates their knowledge. There is no finding that they were dominated or controlled (cf. *Michelson* v. *Penney*,† 135 F. 2d 409, 415-416),—finding 80 necessarily implies no domination or control (p. 1266),—or that they were ignorant of facts sufficient to put them upon inquiry. The claim is therefore barred even under the 'discovery' section."

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* As to what constitutes facts sufficient to put it upon inquiry, *i. e.*, 'discovery', see:

Klotz v. *Angle*, 220 N. Y. 347, 360, 361;
Higgins v. *Crouse*, 147 N. Y. 411, 415.

† That domination and control does not toll the New York Statute is clear from the cases heretofore cited, decided after *Michelson* v. *Penney*.